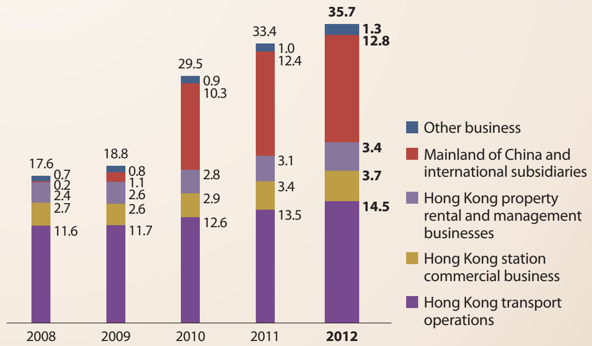
Financial Review

Turnover

With the continued stable economic conditions and improved performance of Mainland of China and international subsidiaries, turnover in 2012 increased across all business segments to a total of HK$35.7 billion.

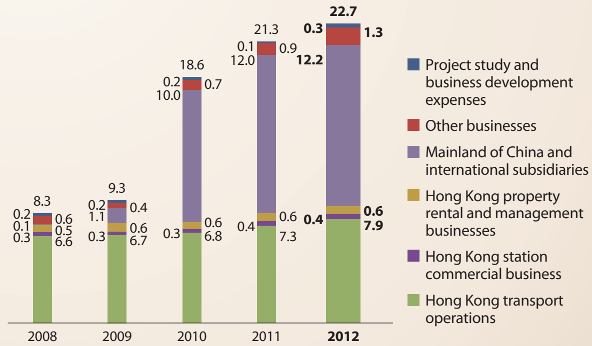
(HK$ billion)



Operating Expenses

More operating expenses were incurred in 2012 to support the revenue growth, service enhancement under the Listening • Responding Programme as well as new business developments outside of Hong Kong.

(HK$ billion)



Review of 2012 Financial Results

Profit and Loss

In 2012, the Group continued to leverage off stable economic conditions to deliver strong financial results.

Fare revenues from Hong Kong transport operations in 2012 increased by 7.7% to HK$14,389 million as a result of strong patronage growth due to favourable economic conditions as well as increased tourist arrivals. Patronage of the Domestic Service, Cross-boundary Service and the Airport Express rose by 4.7%, 5.6% and 7.6% respectively while total patronage of Light Rail and Bus rose by 3.9%. Average fares of the Domestic Service, Cross-boundary Service as well as Light Rail and Bus increased by 2.9%, 2.4% and 1.5% respectively as a result of the fare changes in accordance with the Fare Adjustment Mechanism ("FAM") net of fare promotions, while the average fare of the Airport Express, which is not subject to the FAM, decreased by 1.6% mainly due to the change in passenger mix. Fare revenues in 2012 amounted to HK$10,035 million for the Domestic Service, HK$2,847 million for the Cross-boundary Service, HK$795 million for the Airport Express and HK$578 million for Light Rail and Bus with growth in the range of 5.7% to 8.1%. Including fare revenues from Intercity of HK$134 million and other rail related income of HK$134 million, total revenue from Hong Kong transport operations grew by 7.5% to HK$14,523 million. Expenses relating to Hong Kong transport operations increased by 6.5% to HK$7,829 million mainly due to increased level of manpower, energy, repairs and maintenance as well as costs associated with the service enhancement initiatives under the Listening • Responding Programme coupled with rate increase in staff salaries, energy tariff and government rent and rate assessment. Operating profit from Hong Kong transport operations in 2012 was HK$6,694 million, an increase of 8.8% compared to 2011 with an operating margin of 46.1%

Hong Kong station commercial business reported a 7.5% increase in revenue to HK$3,680 million in 2012. Excluding the non-recurring income in relation to the termination of 2G telecommunication contracts in both 2011 and 2012, revenue growth would have been 11.6% mainly due to the good performance in advertising and station shop rentals driven by the buoyant retail market coupled with patronage growth. Income from advertising increased by 12.0% to HK$1,000 million whilst rental revenue from station shops including the Duty Free Shops increased by 12.4% to HK$2,142 million. Expenses in relation to Hong Kong station commercial business increased by 10.9% to HK$397 million mainly due to increased advertising agency fees in line with advertising revenue growth as well as government rent and rates. Operating profit from Hong Kong station commercial business therefore increased by 7.1% to HK$3,283 million with operating margin at 89.2%.

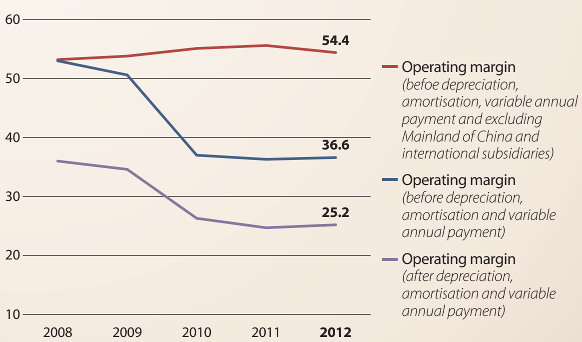
Hong Kong property rental and management businesses also benefited from the strong retail environment to generate a 10.3% increase in revenue to HK$3,401 million. Property rental income rose by 10.5% to HK$3,198 million due to favourable rental reversion, increased turnover rent as well as the opening of PopCorn in March 2012. Property management income rose by 6.8% to HK$203 million due to intake of new managed properties in 2012 and the full-year impact of the 2011 additions. Expenses relating to Hong Kong property rental and management businesses increased by 6.8% to HK$627 million. The resulting operating profit from Hong Kong property rental and management businesses was HK$2,774 million, an increase of 11.1% from last year with an operating margin of 81.6%.

Mainland of China and international subsidiaries, comprising rail franchise operations in Stockholm, Melbourne and Shenzhen as well as property rental and management activities in the Mainland of China, reported a 3.0% increase in revenue at HK$12,786 million and a 1.8% increase in operating expenses at HK$12,184 million. Operating margin was at 4.7%. The resulting operating profit increased significantly by 34.7% to HK$602 million mainly due to the first full-year of operation of the Shenzhen Metro Longhua Line as well as

Operating Margin

Operating margin excluding Mainland of China and international subsidiaries slightly decreased in 2012 due to more project management services to the Government at zero profit margin and increase in business development expenses.

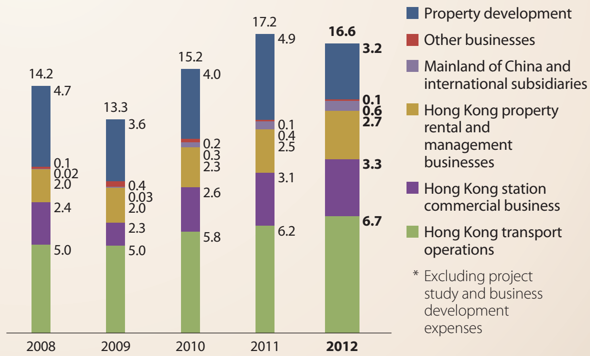
(Percentage)



Operating Profit Contributions*

Contribution from non-recurrent property development profits fluctuated while recurrent business profit achieved steady growth over the years.

(HK$ billion)



continuous improvement in the performance of Metro Trains Melbourne Pty. Ltd.. The franchise operations in Stockholm and Melbourne reported operating profit increases of 1.8% and 16.8% respectively to HK$56 million and HK$467 million respectively. On a constant exchange rate basis, the profit growth would have been 8.8% and 17.9% respectively. Operating profit from Shenzhen Metro Longhua Line was HK$61 million while operating profit from property rental and management businesses was HK$18 million.

Other businesses, comprising Ngong Ping 360, consultancy business and project management service to the Government for the entrustment works regarding the Express Rail Link and Shatin to Central Link, contributed an operating profit of HK$53 million, a 37.6% decrease from last year. The decrease was attributable to Ngong Ping 360 in relation to the expenses on unscheduled repairs and maintenance works and loss in revenue during the suspension of cable car service. With the signing of the final entrustment agreement with Government in relation to the Shatin to Central Link, booking of the related project management fees on a cost recovery basis commenced in 2012.

Including expenses on project studies and new business development of HK$323 million, which increased by 162.6% due to bidding expenses for the Essex Thameside and Thameslink franchises in the UK as well as mobilisation cost of HK$119 million for the opening of Hangzhou Metro Line 1, operating profit before property development, depreciation, amortisation and variable annual payment increased by 7.9% to HK$13,083 million. Operating margin improved from 36.3% in 2011 to 36.6% in 2012. Excluding contributions from the Mainland of China and international subsidiaries, operating margin decreased from 55.6% to 54.4% due to the increase in zero margin project management services to the Government and the above noted increase in expenses on project studies and new business development; excluding such factors, the profit margin would have improved by 0.5 percentage point.

Property development profit in 2012 was HK$3,238 million, comprising profit recognition from The Riverpark at Che Kung Temple Station, surplus from the sale of inventory units mainly at Festival City in Tai Wai and The Palazzo in Fo Tan and agency fee from the West Rail property development at Tuen Mun. Compared with 2011 when we booked significant profit relating to the Festival City development, property development profit in 2012 decreased by HK$1,696 million.

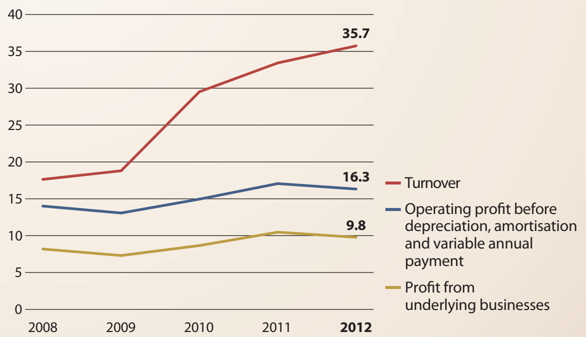
Depreciation and amortisation was at similar levels to 2011 at HK$3,208 million. Variable annual payment to Kowloon-Canton Railway Corporation ("KCRC") was HK$883 million, increasing by 36.5% as relevant revenues have reached the highest 35% band. Although the weighted average cost of borrowing increased from 3.1% in 2011 to 3.3% in 2012, net interest and finance charges decreased by 4.6% to HK$879 million due to an increase in deposit interest and investment income. Investment property revaluation gain recognised in 2012 was HK$3,757 million versus HK$5,088 million in 2011. With a change in accounting standard effective on 1 January 2012, deferred tax provision on investment property revaluation is no longer required and corresponding adjustments have been made for prior years.

The Group's share of profits from non-controlled subsidiaries and associates increased significantly by 53.5% to HK$456 million even after accounting for the HK$60 million of our share of loss from Hangzhou MTR Corporation Limited ("HZMTR") after commencement of service on Hangzhou Metro Line 1 in November 2012. Profit sharing from Octopus Holdings Limited grew by 15.9% to HK$211 million while the share of profit from Beijing MTR Corporation Limited ("BJMTR") increased by 200% to HK$252 million, of which HK$66 million was attributable to the finalisation of accounting adjustments relating to prior years. Share of profits from the other associates increased by 71.0% to HK$53 million mainly due to good performance of our associate companies in London and Stockholm.

Net Results from Underlying Businesses

Underlying business profit in 2012 slightly decreased to HK$9.8 billion due to reduction in property development profits.

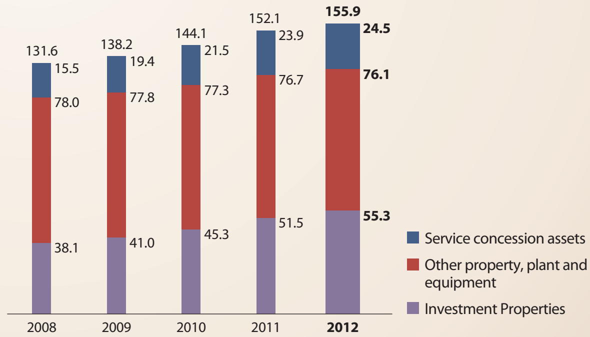
(HK$ billion)



Fixed Assets Growth

Fixed assets at 2012 year-end further increased to HK$155.9 billion with the revaluation gains in investment properties and capital expenditures on additional service concession assets.

(HK$ billion)



With lower property development profit and investment property revaluation gain, net profit attributable to shareholders after deducting HK$1,893 million of income tax and HK$139 million of profit shared by non-controlling interests was HK$13,532 million, decreasing by 13.0% from prior year. Earnings per share therefore decreased from HK$2.69 to HK$2.34. Excluding investment property revaluation, the underlying profit attributable to equity shareholders was HK$9,775 million with earnings per share also decreasing from HK$1.81 in 2011 to HK$1.69. Underlying profit saw a strong contribution from our recurrent businesses with a 13.3% increase in profitability to HK$7,071 million but a reduction in post-tax property development profits from HK$4,225 million to HK$2,704 million.

In line with our progressive dividend policy, the Board has recommended a final dividend of HK$0.54 per share, which, when added to the interim dividend of HK$0.25 per share, will bring the full year dividend to HK$0.79 per share, an increase of HK$0.03 per share or 3.9% from last year.

Balance Sheet

The Group's balance sheet further strengthened during the year with net assets increasing from HK$134,649 million at the beginning of 2012 to HK$144,480 million at the end of 2012.

Total assets increased from HK$197,870 million at 2011 year-end to HK$206,915 million at 31 December 2012. Total fixed assets increased by HK$3,826 million to HK$155,894 million mainly due to revaluation gains on investment properties and self-occupied properties. Railway construction in progress increased by HK$3,892 million to HK$7,458 million with further construction works for the South Island Line (East) and Kwun Tong Line Extension. Interest in associates increased by HK$2,877 million mainly due to the equity injection of HK$2,734 million (RMB2,225 million) into our new associate, HZMTR. With the recognition of property development profits from The Riverpark and sale of inventory units, property development in progress and properties held for sale both decreased by HK$1,534 million and HK$741 million to HK$10,430 million and HK$3,016 million respectively. During 2012, all the remaining investment in bank medium term notes was redeemed upon maturity. As a result, investment in securities decreased by HK$2,581 million to HK$393 million while cash, bank balances and deposits increased by HK$2,564 million to HK$18,664 million.

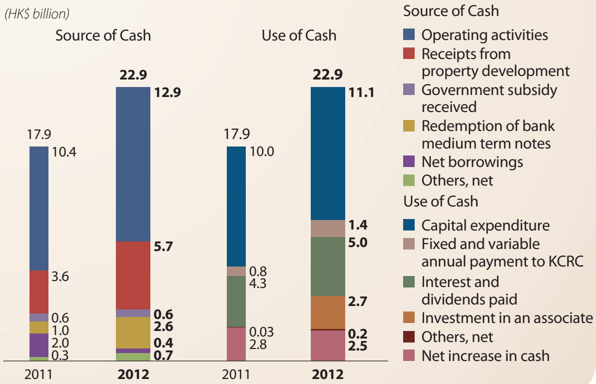
Total liabilities decreased from HK$63,221 million at 2011 year-end to HK$62,435 million at 31 December 2012 mainly due to decreases in creditors and accrued charges as well as amounts due to related parties. Creditors and accrued charges decreased by HK$1,283 million to HK$15,119 million as a result of further utilisation of the government grant for construction of the West Island Line, the cumulative project costs of which, including interest capitalisation, at 2012 year-end was HK$11,191 million. Amounts due to related parties decreased by HK$420 million to HK$1,061 million mainly due to reimbursement to KCRC of property enabling works cost incurred for the Tai Wai Station site in accordance with the Rail Merger agreements. These reductions in liabilities were partly offset by the increase in contract retention of HK$305 million following the progress of railway extension projects, increase in tax liabilities of HK$168 million and increase in total loan outstanding of HK$409 million to HK$23,577 million.

Share capital, share premium and capital reserve increased by HK$219 million to HK$44,281 million from new shares issued under the share option schemes. Together with the increase in retained earnings, net of dividends paid, of HK$9,139 million and increase in fixed asset revaluation reserve and other reserves of HK$452 million, total equity attributable to shareholders of the Company increased by HK$9,810 million to HK$144,273 million at 31 December 2012.

The net debt-to-equity ratio improved from 11.4% at 2011 year-end to 10.9% at 2012 year-end.

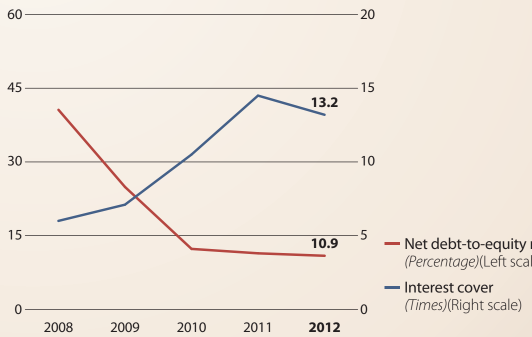
Cash Utilisation

The increase in cash inflows from operating activities and property developments in 2012 were utilised to pay off the increase in capital expenditures and dividends as well as equity injection into an associate.



Debt Servicing Capability

Gearing ratio further improved to 10.9% in 2012.



Cash Flow

Excluding working capital movements, net cash inflow generated from operating activities of the Group before tax payment increased by 7.8% to HK$13,151 million. During the year, working capital movements resulted in a net cash inflow of HK$1,550 million, a significant increase from HK$289 million in 2011 mainly due to receipts of rental deposits for the renewed Duty Free Shop licence. After receipt of the government subsidy of HK$637 million (RMB522 million) for the Shenzhen Metro Longhua Line and tax payment of HK$1,799 million, net cash inflow from operating activities was HK$13,539 million, a 22.8% increase from last year. Cash receipt from property developments was HK$5,677 million mainly relating to the units sold at Festival City and land premium recovered in respect of The Riverpark. Including HK$489 million of dividend and loan repayments received from non-controlled subsidiaries and associates and HK$156 million of receipts from the aggregate impact of new shares issued under the share option schemes, disposal of fixed assets and net amount for investment in securities, total cash inflow in 2012 was HK$19,861 million.

Total capital expenditure outflow in 2012 was HK$11,125 million, including HK$2,327 million for the purchase of assets for Hong Kong transport and related operations, HK$6,353 million for the West Island Line, South Island Line (East) and Kwun Tong Line Extension projects, HK$852 million for settlement of retention and other construction costs relating to the construction of Shenzhen Metro Longhua Line Phase 2 and HK$1,544 million for property developments, renovation and fitting-out works. During the year, the Company paid HK$148 million of net payment in respect of the entrustment works of the Shatin to Central Link and injected HK$2,734 million of equity injection into HZMTR. After settlement of fixed and variable annual payments of HK$1,397 million, net interest payment of HK$438 million and dividend payments of HK$4,519 million, total cash outflow of the Group in 2012 was HK$20,361 million.

As a result, the Group recorded a net cash outflow of HK$500 million, which was covered by existing cash balances. Redemption of bank medium term notes, together with net loan drawdown of HK$385 million, increased the Group's cash balance by HK$2,509 million to HK$18,609 million at 31 December 2012.

Financing Activities

With economic growth in the US remaining weak and unemployment relatively high, the US Federal Reserve continued an extraordinarily accommodative monetary policy in 2012. This, combined with political uncertainties created by the US 'fiscal cliff' and capital flight from Europe, led to substantial safe haven demand for US Treasuries and significant decline in yields.

Under these circumstances, 10-year Treasury yield sank to a historical low of 1.3875% per annum in July before finishing the year at 1.7574% per annum after the 'fiscal cliff' situation was temporarily resolved and the European sovereign debt crisis stabilized. Mirroring the Treasury market, yields on Hong Kong Exchange Fund Notes trended down with 10-year yield reaching an all-time low of 0.5% per annum in November before ending the year at 0.598% per annum.

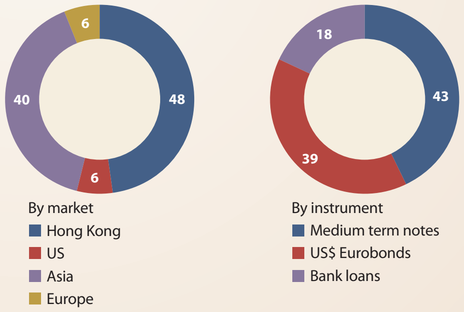
Short-term interest rates were slightly higher in both the US and Hong Kong reflecting tighter liquidity in the bank markets. Average 3-month US$-LIBOR and 3-month HK$-HIBOR rose to around 0.43% per annum and 0.40% per annum in 2012 from 0.34% per annum and 0.27% per annum respectively.

Supported by historically low Treasury yields, tightening credit spreads and strong demand from investors wanting to diversify risks, the US dollar bond market for Hong Kong issuers was exceptionally strong in 2012 with record issuance volume and issuers readily able to obtain sizeable financings. Taking advantage of such favourable conditions, the Group launched a 5-year US$300 million public bond in March. With a strong order book of US$1.7 billion, the bond was priced at

Sources of Borrowing

Although Hong Kong is our main market, our strategy is to diversify our funding sources and maintain ready access to other important international markets.

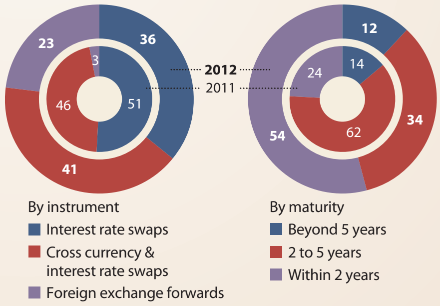
(Percentage) (As at 31 December 2012)



Use of Interest Rate and Currency Risk Hedging Products

The Company uses derivative financial instruments for hedging purposes, and has a strict policy of limiting their usage for hedging purposes only.

(Percentage) (As at 31 December 2012)*



* Calculated based on nominal value

a coupon rate of 2% per annum, the lowest achieved by an Asian issuer at the time, and an effective yield of 2.175% per annum, or 115 basis points over 5-year Treasury.

In response to reverse enquiries to meet unsatisfied demand for our 5-year US dollar bond and to take advantage of further decline in Treasury yields and credit spreads, the Group followed up with a US$250 million re-opening of this 5-year bond in November 2012. With an order book of US$773 million, the new bonds were priced at a yield of 1.456% per annum, or 80 basis points over 5-year Treasury, one of the lowest ever achieved by an Asian issuer for a US dollar 5-year bond.

The favourable condition in the bond market however was not matched in the loan market. During the year banks remained reluctant to lend as they continued to deleverage and face higher funding costs resulting from the more stringent liquidity and capital requirements under the Third Basel Accord, which will be phased in from 1 January 2013.

Despite these challenges, the Group leveraged our strong banking relationships to arrange total bilateral banking facilities amounting to HK$5,200 million, comprising 3- to 5-year revolving term loan facilities at attractive all-in costs.

Supplementing these transactions, the Group also issued a number of medium term notes through private placement out of our Debt Issuance Programme, including an Australian Dollar 50 million 5-year fixed-rate note converted to floating-rate HK dollars, a HK$500 million 5-year fixed-rate note, a HK$300 million 8-year fixed-rate note and a HK$500 million 10-year fixed-rate note.

Cost of Borrowing

The Group's consolidated gross debt position increased slightly from HK$23,168 million at 2011 year-end to HK$23,577 million at 2012 year-end. Weighted average borrowing cost increased slightly to 3.3% per annum, from 3.1% per annum in 2011 as a result of higher average floating rate borrowing costs in Hong Kong and Mainland China as well as increased finance charges incurred for new financings. Despite higher average debt level and higher average borrowing cost in 2012, net interest expense charged to the Profit and Loss Account, after interest capitalised of HK$103 million and the set-off of part of the government grant to MTR Corporation (Shenzhen) Limited of HK$254 million, decreased to HK$879 million from HK$921 million in 2011, primarily due to increase in interest income from the Group's surplus cash.

Treasury Risk Management

The Board of Directors approves policies for overall treasury risk management covering areas of liquidity risk, interest rate risk, foreign exchange risk, credit risk, concentration risk, use of derivative financial instruments, and investment of excess liquidity.

The Group's well established Preferred Financing Model (the "Model") is an integral part of our risk management policy. The Model specifies the preferred mix of fixed and floating rate debts, sources of funds from capital and loan markets, and debt maturity profile as well as a permitted level of foreign currency debts and an adequate length of financing horizon for coverage of forward funding requirements, against which financing related liquidity, interest rate and currency risks are monitored and controlled.

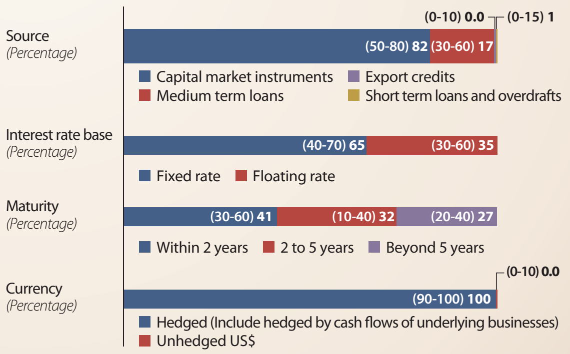
In accordance with Board policy, derivative financial instruments shall only be used for controlling or hedging risk exposures, and not for speculation. Derivative instruments currently used by the Group are over-the-counter derivatives comprising mainly interest rate swaps, cross currency swaps and foreign exchange forward contracts.

To control and diversify counterparty risks, the Group limits exposure to credit risk by placing deposits and transacting derivative instruments with financial institutions having acceptable investment grade credit ratings.

Preferred Financing Model and Debt Profile

The Preferred Financing Model exemplifies the Company's prudent approach to debt management and helps ensure a well balanced debt portfolio.

(Preferred Financing Model) *vs.* **Actual debt profile** *As at 31 December 2012*



In accordance with Board policy, all derivative instruments with counterparties are subject to a counterparty limit based on the counterparty's credit ratings. Credit exposure is estimated based on estimated fair market value and largest potential loss arising from these instruments using a "value-at-risk" concept, and monitored and controlled against respective counterparty limits. To further reduce risk, the Group applies set-off and netting arrangements across different instruments with the same counterparty.

Deposits and short-term investments are subject to separate counterparty limits based on the counterparty's credit ratings, their note issuing bank status in Hong Kong, and the length of time that a deposit or short-term investment to be maintained with that counterparty.

The Group actively monitors credit ratings and credit related changes of all its counterparties using additional information such as credit default swap levels, and will, based on these changes, adjust the counterparty limits accordingly.

In managing liquidity risk, the Group will maintain sufficient cash balance and undrawn committed banking facilities to provide forward coverage of at least 6 to 15 months of projected cash requirements. The Group also conducts regular stress testing of projected cash flow to identify and estimate potential shortfall, and would arrange new financings or take other appropriate actions if such stress tests reveal significant risk of material cash flow shortfall.

Credit Ratings

Throughout the year, the Company's credit ratings remained on par with those of the Hong Kong SAR Government.

The Company's issuer and senior unsecured debt ratings as well as short-term rating were affirmed in June by Moody's at respectively "Aa1" and "P-1" with a stable outlook.

In October, the Company's issuer and short-term credit ratings were affirmed by Rating & Investment Inc. of Japan at respectively "AA+" and "a-1+", with a stable outlook.

This was followed in December by S&P's affirmation of the Company's long-term corporate credit and short-term ratings of respectively "AAA" and "A-1+" with a stable outlook.

Financing Capacity

The Group's capital expenditure programme consists of three parts – Hong Kong railway projects, Hong Kong property investment and development, and Mainland China and overseas investments.

Capital expenditure for Hong Kong railway projects comprises investment in and expenditures relating to new ownership projects, including the West Island Line, South Island Line (East) and the Kwun Tong Line Extension, as well as outlays for maintaining and upgrading the existing rail lines. Concession projects such as the Express Rail Link are generally funded by the Government although for the Shatin to Central Link, the company has agreed to pay for certain portions of costs for rolling stock and signalling.

Capital expenditure for Hong Kong property investment and development comprises mainly costs of enabling works for property development, fitting-out and renovation works of shopping centres as well as potential payments of a portion of land premium for our property development projects. Expenditure for Mainland China and overseas investments consists primarily of additional equity contribution to BJMTR for the Beijing Metro Line 14 project, remaining capital expenditure for Shenzhen Metro Longhua Line, and investment in the Longhua depot property development project.

Based on current programme, total net capital expenditure for the next three years from 2013 to 2015 (inclusive) is estimated at HK$28.7 billion for Hong Kong railway projects, HK$17.1 billion for Hong Kong property investment and development, and HK$7.0 billion for Mainland China and overseas investments, a total of HK$52.8 billion. Out of this total, it is estimated that HK$29.0 billion will be incurred in 2013, HK$13.5 billion in 2014, and HK$10.3 billion in 2015.

At the end of 2012, the Company had total cash and bank deposits of HK$16,616 million as well as undrawn committed banking facilities of HK$4,900 million, which, together with future projected cash flow, will help provide forward coverage of the Company's funding needs well into 2013.

Credit ratings	Short-term ratings*	Long-term ratings*
Standard & Poor's	A-1+/A-1+	AAA/AAA
Moody's	-/P-1	Aa1/Aa1
Rating & Investment Information, Inc. (R&I)	a-1+	AA+

* Ratings for Hong Kong dollar/foreign currency denominated debts respectively